

# The Size Premium Lives, But Not for All Small-Company Stocks

✘ One driver of stock price returns debated among research papers is the size premium. The size premium—also known as small minus big (SMB)—is the historical outperformance of small-company stocks relative to large-company stocks. The continued existence of this so-called anomaly has been called into question because of the essentially equal returns between small- and large-company stocks since 1982.

*SMALL COMPANIES*  
+  
*DESIRABLE TRAITS*  
=  
*HIGHER RETURNS*

The data gives both opponents and proponents of the small-cap premium facts to base their arguments on. Since the 1981 publication of Rolf Banz's *Journal of Financial Economics* study, "The Relationship Between Return and Market Value of Common Stocks," aggregate returns have stopped showing a longstanding premium. Rather, a portfolio of equal-weighted large-company stocks realized an annualized return of 12.3% versus the 12.2% annualized return for an equal-weighted small-company portfolio. (I used Dartmouth professor Kenneth French's data library for the return data.)

Proponents of the size premium, however, can point to other data. Over the longer period of 1927 through 2017, small-company stocks had a 4.5 percentage-point annualized return advantage (14.9% versus 10.4%). Grouping stocks by value versus growth (or high versus low momentum) provides evidence of the premium's continuing existence. A recently updated study by Clifford Asness of hedge fund AQR Capital found that grouping stocks by quality also shows that the demise of the size premium is greatly exaggerated.

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- [How Much Small Cap Should Be in Your Portfolio?](#) - Small-cap stocks provide diversification benefits to a large-cap stock portfolio, but personal factors should influence how large the allocation to small-cap stocks should be.
  - [Exploiting the Relative Outperformance of Small-Cap Stocks](#) - The small-cap premium has been most significant during periods of economic expansion.
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### Highlights from this month's *AAll Journal*

- [The Individual Investor's Guide to the Top Mutual Funds 2018](#) - Our annual mutual fund guide is fully updated. The online version of this guide has information on nearly 1,600 funds.
  - [Volume Surges Have a Fading Impact on Returns](#) - An unusually large increase in monthly trading volume leads to higher returns, but the effect lasts for less than 12 months.
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### AAll Sentiment Survey

Neutral sentiment rose to a three-month high. Plus, the majority of surveyed AAll members said they made limited or no changes to their portfolios in response to this month's correction. [More about this week's results.](#)

#### **This week's results:**

- Bullish: 44.7%, down 3.9 points
- Neutral: 32.6%, up 2.5 points
- Bearish: 22.8%, up 1.4 points

#### **Historical averages:**

- Bullish: 38.5%
- Neutral: 31.0%
- Bearish: 30.5%

Take the [Sentiment Survey](#).

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## What's Trending on AAI

1. [The Individual Investor's Guide to the Top Mutual Funds 2018](#)
  2. [Allocating to Manage Risk: A Case Study](#)
  3. [A Former Hedge Fund Manager's Contrarian Strategy](#)
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## The Week Ahead

Many retailers will report earnings, including Macy's Inc. (**M**) on Tuesday, Lowe's Companies Inc. (**LOW**) on Wednesday and Best Buy Co. Inc. (**BBY**) on Thursday. Joining them will be nearly 30 other members of the S&P 500, including Priceline Group Inc. (**PCLN**) on Tuesday.

The week's first economic report will be January new home sales, released on Monday. January durable goods orders, January international trade, the December S&P CoreLogic Case-Shiller home price index and the Conference Board's February consumer confidence survey will be released on Tuesday. Wednesday will feature the first revision to fourth-quarter GDP, the February Chicago Purchasing Managers' Index (PMI) and the January pending home sales index. On Thursday, January personal income and spending, the February PMI Manufacturing Index, the ISM's February manufacturing index and January construction spending will be released. The University of Michigan's final February consumer sentiment survey will be released on Friday.

Three Federal Reserve officials will make public appearances this week: St. Louis president James Bullard on Monday, Jerome Powell on Wednesday and New York president William Dudley on Thursday.

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## Local Chapter Meetings

AAII Local Chapter Meetings offer you a variety of presentations from expert speakers who will give you their view on the world of investing. A bonus of attending a Chapter Meeting near you is the opportunity to meet other AAI members who share your interest and enthusiasm for investing. You

can even share the Chapter experience with your family and friends by inviting them to attend Chapter Meetings with you!

[Upcoming Meetings »](#)